No. 2950

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit.

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JOSEPH J. SCOTT, as Collector of Internal Revenue of the United States for the First Collection District of California,

Appellant,

vs.

WESTERN PACIFIC RAILROAD COMPANY, and FRANK G. DRUM and WARREN OLNEY, JR., Receivers of the Property of the WESTERN PACIFIC RAILWAY COMPANY,

Appellees.

BRIEF FOR APPELLEES

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Filed this.....day of May, 1917.

FRANK D. MONCKTON, Clerk.

By....., Deputy Clerk.

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Statement of Facts

The question involved in this case is whether the income derived from the operation by Receivers of the property of the Western Pacific Railway Company is liable to income tax under the Act of Congress. The Commissioner of Internal Revenue held that the corporation, Western Pacific Railway Company, should be reported for assessment and also that the interest which had accrued on its funded

indebtedness should not be deducted from operating income because the same had not been actually paid (Trans. p. 13).

On May 18th, 1916, Frank G. Drum and Warren Olney, Jr., the Receivers appointed in an action pending in the District Court of the United States in and for the Northern District of California, Second Division, entitled *The Equitable Trust Company of New York, plaintiff,* vs. *Western Pacific Railway Company, et al., defendants,* petitioned said Court in reference to the question of the payment of income tax under the provisions of the Act of Congress approved October 3rd, 1913. (38 Stat. at L. 166, Ch. 16; Comp. Stat. 1913 Secs. 6319-36) (Trans. pp. 10-14). The prayer of the petition asked that a citation issue out of said Court directed to Joseph J. Scott, Collector of Internal Revenue, directing him to appear before that Court and show cause why the statement theretofore filed with the said Collector should not be accepted, and further praying that the Court make its order finding that certain interest which was included in the statement so filed was a proper deduction, and further that an order should be made that the Receivers should not be held to pay any income tax (Trans. p. 14). The record does not disclose whether the citation was ever issued, but it does appear that the matter came on to be heard before the Honorable District Court on June 26th, 1916 (Trans. pp. 9-10), when the said Joseph J. Scott, Collector of Internal Revenue, moved to dismiss the petition filed by the Receivers (Trans. pp. 15-17).

The record is again silent as to whether any action was taken by the Court on the Collector's motion to dismiss the petition of the Receivers. On August 21st, 1916, the Court made an order instructing the Receivers that no payment of any income tax should be made, which order is in the following words:

> "The receivers' application for instructions of the Court in regard to income tax, heretofore submitted, being fully considered and the Court having filed its memorandum opinion, it is ordered that the receivers are instructed that no payment of any income tax should be made. Ordered that the order to show cause on the Collector of Internal Revenue be dismissed." (Trans. p. 4.)

This is the only order which the Court made, either on the petition or on the motion of the Collector to dismiss the petition, and is the order from which the said Joseph J. Scott, as Collector of Internal Revenue, appeals,—he having filed in the said District Court on December 14th, 1916, a petition addressed to the Honorable Wm. C. Van Fleet, Judge of the United States District Court in and for the Northern District of California, in which he recited that, "* * * feeling himself aggrieved by the order made and entered in this cause *(The Equitable Trust Company of New York* vs. *Western Pacific Railway Company, et al.)* on the 21st day of August, 1916, does hereby appeal from said order to the Circuit Court of Appeals for the Ninth Circuit, * * *". (Trans. p. 5.) On the same day the District Court made an order allow-

ing such appeal "* * * from the order and decree heretofore filed and entered herein, on August 21st, 1916." (Trans. p. 9.)

Except as modified by the above statement, the facts as presented in the statement of the case in the Appellant's brief are substantially correct.

Argument.

In discussing this case, we will do so under the following heads:

1st. The Court had jurisdiction on petition of Receivers appointed by it, to direct the Receivers that no income tax should be paid by them.

2nd. The Act of Congress of October 3rd, 1913, in relation to the levy, assessment and collection of income tax does not require receivers of a corporation appointed by a court to make an income tax return.

3rd. Even if this Court should determine that the Act of Congress approved October 3rd, 1913, required receivers of a corporation to make a return of the income derived through their operation of the property of the corporation, still such receivers should deduct from the income derived from such operation the interest which accrued on the indebtedness of the corporation whose property was being operated by the Court through its receivers and this notwithstanding that such interest had not actually in fact been paid.

I.

Did the lower Court have jurisdiction to make its order appealed from?

It is contended by the Appellant that the Court exceeded its jurisdiction in issuing its instruction to its own Receivers because it was in effect in violation of Section 3224, Revised Statutes (Comp. Stat. 1916, Sec. 5947), which provides that "No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court."

The petition of the Receivers to the Court which appointed them (Trans. pp. 10-14) and the order of the Court directing that its Receivers should not pay any income tax (Trans. p. 19) seem sufficient in and of themselves to refute the proposition that this in any sense could be taken to be a suit to restrain the assessment or collection of a tax.

In the first place, the Receivers appointed by the Court are officers of that Court in the administration of the property which is in the hands of the Court. *Quincy M. & P. R. Co.* vs. *Humphreys,* 145 U. S. 82, at page 98; 36 L. Ed. 632, at page 637; *International Trust Co.* vs. *Decker Bros.* (9th C. C. A.) 152 Fed. 78 at page 82; 11 L. R. A. N. S. 152, at page 156; High on Receivers, Sec. 1; *Reardon* vs. *Youngquist* 189 Ill. App. 3 at page 12. Receivers, therefore, being officers of the Court, can and should make inquiry of the Court for instructions regarding the administration of the property in their hands. *Missouri Pac. Ry. Co.* vs. *T. & P. Ry. Co.,* 31 Fed. 862;

Chable vs. *Nicaragua C. C. Co.,* 59 Fed. 846; *People ex rel. Attorney General* vs. *Security L. Ins. Co.,* 79 N. Y. 267, at page 270; High on Receivers, Sec. 188; Foster, Federal Practice, Sec. 310; *Grant* vs. *Phoenix L. Ins. Co.,* 121 U. S. 118, 30 L. Ed. 909; *Schwartz* vs. *Keystone Oil Co. (Pa.),* 25 Atl. 1018; *Weeks* vs. *Cornwell (N. Y.),* 13 N. E. 96.

The case of *Ex Parte Chamberlain,* 55 Fed. 704, arose on the petition of a receiver of the property of a railway company asking the protection of the Court to prevent the enforcement of the payment of certain local taxes. The Court said:

> "There can be no doubt that property in the hands of a receiver of any court, either of a state or of the United States, is as much bound for the payment of taxes, state, county, and municipal, as any other property. Persons cannot, by coming into this court, and, for the promotion of their interests, applying for and obtaining the appointment of receivers, obtain exemption from the paramount duty of a citizen. For this reason receivers in this district pay all just and lawful taxes without asking or needing the sanction of the court, and in their accounts such payments are passed without question. But, on the other hand, receivers are not bound to pay a tax in their judgment unlawful, without the order of the court; and when they consider the legality of the tax questionable it is their right—their manifest duty—to apply to the court either for instruction or protection. Especially is this the case when the question arises between the receiver and persons in the state, county, and municipal government as to the proper construction to be given to the law, upon which individuals may well differ, and it is his right and manifest duty to go to

> the court, whose creature he is, for instruction. He therefore pursued the proper course when he came in by this petition."

The Court then proceeded to consider the validity of the tax in question and, after citing authorities which held it invalid, said:

> "When, therefore, the receiver comes into this court and asks instructions, predicating his action on the decision in this case, we grant him relief by suspending the collection of the tax until the presumption of the soundness of this decision has been overcome."

This same case was taken to the United States Supreme Court under the title *Ex Parte Tyler,* 149 U. S. 164, 37 L. Ed. 689, the Court, speaking through Mr. Chief Justice Fuller, said:

> "And when controversy arises as to the legality of the tax claimed there ought to be no serious difficulty in adjusting such controversy upon proper suggestion. The usual course pursued in such cases is by intervention *pro interesse suo,* as in the instance of sequestration. The tax collector is a ministerial officer, and no reason is perceived why he should not bring his claim to the attention of the court, while on the other hand it is clearly the duty of the receiver to do so, if he contends that the taxes are illegal. If found valid, they must be paid; if invalid, the court will so declare, subject to the review of the appellate tribunals."

In *Ledoux* vs. *LaBee,* 83 Fed. 761, a receiver requested instructions of the Court as to the validity of certain local taxes imposed on the property in his

hands. The Court, in sustaining its jurisdiction of the controversy, said:

> "this court, having possession of the property and assets of the Harney Peak Company through its receiver, has jurisdiction to inquire into the legality of any claim sought to be enforced against it, or the legality and lawfulness of any invasion of said possession, independent of any grounds of equitable jurisdiction, which must exist in other cases."
>
> * * * "This action, brought by the receiver, is therefore properly instituted, and in such form as to allow the legality of the claim for taxes for the payment of which the property has been seized to be determined."
>
> * * * "There can be no doubt of the correctness of the doctrine that property in the possession of a receiver appointed by a court is in *custodia legis,* and that unauthorized interference with such possession is punishable as a contempt; and it cannot be contended that this salutary rule has any exceptions in favor of officers engaged in the collection of taxes." * * *
>
> "The legality of the claim for taxes will now be considered."

This method was pursued in the case of *Pennsylvania Steel Company* vs. *New York City Railway Company,* 176 Fed. 477, 193 Fed. 286, affirmed in 198 Fed. 775, where the receivers had petitioned the Court appointing them to determine whether they should pay the income tax under the Act of Congress of 1909. (Act of Aug. 5, 1909, Sec. 38, 36 Stat. at L. 112, Ch. 6, Comp. Stat. 1913, Secs. 6300-2.) That same case went to the Supreme Court of the United

States under the title of *United States* vs. *Whitridge,* 231 U. S. 144; 58 L. Ed. 159.

See also

Spencer vs. *Babylon R. Co.,* 233 Fed. 803.

In the case of *Brushaber* vs. *Union Pacific Railroad Company,* 240 U. S. 1, 60 L. Ed. 493, a stockholder of the defendant corporation brought an action against that corporation to restrain it from paying the income tax under the Act of Congress of October 3rd, 1913. The defendant corporation refused to defend the action and the Government, through the United States Attorney General, contested the action brought by the stockholder and, among other defenses made, sought to dismiss the action on the ground that the same was, in effect, an action to restrain the assessment or collection of a tax forbidden by Sec. 3224 R. S. The Court in the decision held that the contention that the lower Court had no jurisdiction in the cause was without merit and entertained the action and decided the question on the merits.

We again call the attention of this Court, in order to emphasize the position that we take, to the order made in the lower Court from which the appeal is taken (Trans. p. 4). It does not purport to restrain the Collector of Internal Revenue from assessing or collecting the income tax, but, on the other hand, dismisses the citation which it had previously directed to be issued to the Collector to show

cause why the return made by the Receivers should not be accepted and affirmatively directs its own Receivers not to pay any income tax whatever. In other words,—the property of the Western Pacific Railway Company being in the hands of the United States District Court and being operated by the Court through Receivers appointed by it—the Court, when the question was presented as to whether or not the income tax under the Act of Congress of 1913 should be paid, made its order that no income tax whatever should be paid from its operation through its Receivers. This then was not only *not* a suit for the purpose of restraining the assessment or collection of a tax, but was simply an adjudication by the Court that its Receivers were not liable for the payment of the tax. In the same way the United States Supreme Court in *Brushaber* vs. *Union Pacific Railroad Company, supra*, decided that the defendant corporation in a suit by one of its stockholders was liable for the payment of this same tax. This, we believe, disposes of any question relative to the jurisdiction of the Court in making its order appealed from.

II.

Does the Act of Congress approved October 3rd, 1913, apply to receivers of corporations?

We respectfully submit at the outset that the Act under which the income tax is purported to be imposed must be strictly construed.

In *Pennsylvania Steel Co.* vs. *New York City Railway Co.* (2nd C. C. A.), 198 Fed. 774, the Court laid down the following rule as the basis for its holding that the income tax Act of 1909 did not apply to receivers:

> "The act in question, levying, as it does, a tax upon the citizen, must be strictly construed; it cannot be enlarged by construction to cover matters not clearly within its purport. The question is not what Congress might have done or should have done, but what it actually did do. When this is ascertained the duty of the court is accomplished."

In *Mutual Benefit Life Ins. Co.* vs. *Herold,* 198 Fed. 199, in construing the same Act, it was said:

> "At the outset it may be remarked that a statute providing for the imposition of taxes is to be strictly construed, and all reasonable doubts in respect thereto resolved against the Government and in favor of the citizen."

In *Treat* vs. *White,* 181 U. S. 264, 45 L. Ed. 853, the same rule was expressed in the following language:

> "It is also true, as said by this court in *United States* vs. *Isham,* 17 Wall. 496, 504, 21 L. Ed. 728, 730: 'If there is a doubt as to the liability of an instrument to taxation, the construction is in favor of the exemption, because, in the language of Pollock, C. B., in *Gurr* vs. *Scudds,* 11 Exch. 191, " a tax cannot be imposed without clear and express words for that purpose".' With that proposition we fully agree. There must be certainty as to the meaning and scope of language imposing any tax, and doubt in respect to its meaning is to be resolved in favor of the taxpayer."

In *Eidman* vs. *Martinez,* 184 U. S. 578, 46 L. Ed. 697, the United States Supreme Court again followed the same rule of construction:

> "It is an old and familiar rule of the English courts, applicable to all forms of taxation, and particularly special taxes, that the sovereign is bound to express its intention to tax in clear and unambiguous language, and that a liberal construction be given to words of exception confining the operation of duty (citation) though the rule regarding exemptions from general laws imposing taxes may be different (citations)."

> "We have ourselves had repeated occasion to hold that the customs revenue laws should be liberally interpreted in favor of the importer, and that the intent of Congress to impose or increase a tax upon imports should be expressed in clear and unambiguous language."

The reason for this rule of construction in the interpretation of taxing statutes has been thus expressed by Lord Cairns in *Partington* vs. *The Attorney General,* L. R. 4 E. & I. App. Cas. 100, at page 122:

> "I am not at all sure that, in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other

> words, if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."

The same rule has been applied by this Circuit Court of Appeals in the case of *Lynch* vs. *Union Trust Co.* (9th C. C. A.) 164 Fed. 161, where the Court, in interpreting the legacy tax Act of 1898, said:

> "Primarily in this connection it is necessary to keep in view a cardinal principle, to be applied generally to the interpretation of legislation whereby the Government seeks to impose a duty or burden upon the property or rights of the citizen in the nature of taxation, and more especially applicable to statutes such as this, seeking to impose a burden of a special or unusual character, and that is that, in all cases of doubt or ambiguity arising on the terms of such a statute, every intendment is to be indulged against the taxing power. This principle has been aptly stated in two cases involving the application of the statute under consideration: *Eidman* vs. *Martinez,* 184 U. S. 578, 583, 22 Sup. Ct. 515, 46 L. Ed. 697; *Disston* vs. *McClain,* 147 Fed. 114, 116, 77 C. C. A. 340."

This Court will note that the income tax is included in an Act of Congress approved October 3rd, 1913, and entitled "An Act to Reduce Tariff Duties and to Provide Revenue for the Government, and for Other Purposes." The first part of this Act deals entirely with tariff matters, and, in Section II, imposes the so-called "income tax." This Section II is divided into several subheads running from A to

N, both inclusive. Headings A to F, inclusive, deal with income tax imposed on individuals and heading G, with its several paragraphs, deals with the income tax imposed upon corporations. Headings H to N, inclusive, are general in their nature and pertain to the administration of the Act itself.

Nowhere in heading G is the word "receiver" used, but it does contain an elaborate scheme for the assessment and return to be made by "every corporation, joint stock company or association and every insurance company organized in the United States." This is the same expression used in the income tax law of August 5th, 1909, wherein, in Section 38 of that Act, it is provided that "every corporation, joint stock company or association organized for profit and having a capital stock represented by shares, and every insurance company now or hereafter organized under the laws of the United States * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business." Nowhere in the Act of August 5, 1909, was the word "receiver" used.

In the case of *Pennsylvania Steel Company* vs. *New York City Railway Company,* 176 Fed. 477, which arose under the Act of 1909, the Court said:

> "The Act contains no provisions as to receivers, and it is not thought that Congress intended to include bankrupt corporations with no net income whose properties are being administered by a court. It would seem to be sufficient if at the time fixed for making re-

> turns a statement be filed with the proper officer showing that these roads are in the hands of receivers."

This case came on for rehearing, 193 Fed. 286, where the Court said:

> "It does not seem to me that Congress, while avoiding carefully any taxation of the property of the corporation, intended to impose a tax upon the income realized from the assets of a bankrupt corporation, whose property had been taken over by a court, through its officers to be marshaled and distributed. Certainly the language used does not indicate any such intent."

On appeal before the Circuit Court of Appeals for the Second Circuit, 198 Fed. 774, the Court, speaking through Circuit Judge Coxe, said:

> "We are of the opinion that the Act is inapplicable to receivers for the following reasons:
>
> First—The taxation of business done and income received by receivers is not contemplated by the Act, receivers are not mentioned. This omission cannot be attributed to inadvertence. The lawmakers unquestionably understood the situation; they knew that corporations frequently become bankrupt and are placed in the hands of receivers and yet no provision in the Act relates to this contingency."
>
> * * * "Whatever the reason may have been, the fact remains that the doing of business by receivers in their representative capacity, as officers of the court, is not taxed by the Act and no provision is made therein for the ascertainment and collection of such a tax."

> "* * * It cannot be held that an Act which nowhere mentions receivers and which in every paragraph deals with corporations and joint-stock companies actually engaged in business, can, by construction, be made to cover the business, temporarily undertaken, of conserving the property of such a corporation for the benefit of its creditors and the public."

In the case of the *United States* vs. *Whitridge*, 231 U. S. 144, 58 L. Ed. 159, which grew out of the same receivership, Mr. Justice Pitney said:

> "A reference to the language of the Act is sufficient to show that it does not in terms impose a tax upon corporate property or franchises as such, nor upon the income arising from the conduct of business unless it be carried on by the corporation. Nor does it in terms impose any duty upon the receivers of corporations or of corporate property, with respect to paying taxes upon the income arising from their management of the corporate assets, or with respect to making any return of such income.
>
> And we are unable to perceive that such receivers are within the spirit and purpose of the Act, any more than they are within its letter. True, they may hold, for the time, all the franchises and property of the corporation, excepting its primary franchise of corporate existence. In the present cases, the receivers were authorized and required to manage and operate the railroads, and to discharge the public obligations of the corporations in this behalf. But they did this as officers of the court, and subject to the orders of the court; not as officers of the respective corporations, nor with the advantages that inhere in corporate organization as such. The possession and control of the receivers constituted, on the contrary, an ouster of corporate

management and control, with the accompanying advantages and privileges.

Without amplifying the discussion, we content ourselves with saying that, having regard to the genesis of the legislation, the constitutional limitation in view of which it was evidently framed, the language employed by the lawmaker, and the reason and spirit of the enactment, all considerations alike lead to the conclusion that the Act of 1909 did not impose a tax upon the income derived from the management of corporate property by receivers, under such conditions as are herein presented."

As illustrative of the intent of Congress in intentionally omitting to provide for the filing of an income tax return by the receivers of a corporation under the Act of October 3rd, 1913, we call particular attention to the income tax law of September 8th, 1916, which, in Part II, Section 10 of the Act, provides for the levy, assessment and collection of a tax on the total "net income received in the preceding calendar year from all sources by every corporation, joint stock company, or association, or insurance company, etc." (39 Stat. at L. 765, Ch. 463; Comp. Stat. 1916, Sec. 6336j) in the same way that the Act of 1913 imposed a tax on the net income on the same entities. But, while the Act of 1913 entirely omits any reference to receivers of corporations, Congress has, in the Act of 1916, expressly shown its intention to include receivers. For, in Subdivision (c) of Section 13 of Part II of the Act of 1916, it is provided:

"(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the prop-

> erty or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control (39 Stat. at L. page 771, Comp. Stat. 1916. Sec. 6336-m (c)).

It was the lack of a corresponding section to this in the Act of 1909 which persuaded the Circuit Court of Appeals in *Pennsylvania Steel Co.* vs. *New York City Railway Company (supra)* to declare that it was not the intention of Congress to include receivers of corporations among those who were required to return and pay an income tax, and it is the lack of a corresponding provision to the one above quoted from the Act of 1913 which persuades us to believe that Congress had no intention whatever of imposing the income tax upon receivers of corporations.

If the intent of Congress, under the Act of 1913, had been to include receivers, there is no reason why the amendatory Act of 1916 should have expressly provided that which Congress in the Act of 1913 had intentionally included—in other words, if the language of the Act of 1913 applied to receivers

of corporations, the same language could have been used in the Act of 1916 without the express reference to receivers therein.

It is true that the word "receiver" is used twice in the headings of Section 2 of the Act which relate to the imposition of income taxes on individuals, and is found in headings D and E thereof. Under heading D we find "guardians, trustees, executors, administrators, agents, *receivers,* conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the net income *of the person for whom they act, subject to this tax* coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals." "This tax" is the *tax* imposed on individuals referred to under the preceding headings and the *"person* * * * subject to this tax" is a person who is required to make a return and who is defined as a "person of lawful age * * * having a net income of $3000, or over * * *" (heading D). Such person is authorized under heading C of the Act to "deduct from the amount of the net income * * * the sum of $3000 plus $1000 additional if the person making the return be a married man with a wife living with him" etc. We are mentioning this to draw attention to the fact that this heading which refers to receivers applies to the "individual" and not to a "corporation."

Under heading E "receiver" is again used, viz.: "All persons, firms, copartnerships, companies, cor-

porations, joint stock companies or associations and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees in any trust capacity, executors, administrators, agents, *receivers,* conservators, employers and all officers and employees of the United States having the control, receipt, custody, disposal or payment of interest, rent, salaries, wages * * * are hereby authorized and required to deduct and withhold * * * such sums as will be sufficient to pay the normal tax imposed thereon by this section." In other words, under heading D, those acting in a fiduciary capacity for an individual shall make a return for the individual subject to the tax for whom they (fiduciaries) act, and the same fiduciaries are required by the Act under heading E to withhold at the source the normal tax imposed on the individual and pay to the proper officer of the Government the amounts so withheld.

III.

But if this Court should conclude that the Act of 1913 did apply to Receivers of corporations, then the question arises, viz.:

Should the receivers of a corporation deduct from gross income, interest on the funded indebtedness of the corporation whose property they are controlling and which had accrued but which could not be paid?

It appears from the petition of the Receivers that they filed with the Collector of Internal Revenue in

their district a statement showing the income derived from operation during the year ending December 31st, 1915, and that the gross amount so received was $6,669,577.64. From this they showed deductions in the sum of $9,955,781.59 which included the item of interest amounting to $4,694,238.94 which was shown in tabulated form as having accrued on the amount of funded debt owing by the Western Pacific Railway Company. As explanatory as to why this interest was not paid, the Receivers stated:

> "Above interest due on indebtedness (all forms) of Western Pacific Railway Company, a corporation, but no payments have been actually made inasmuch as the amount available for that purpose, viz.: $1,408,034.99, and which would have been used for such purpose by the Western Pacific Railway Company is held in abeyance and is subject to disposition by order of the United States District Court in and for the Northern District of California, said Court being the Court appointing receivers of the property of Western Pacific Railway Company." (Trans. pp. 11, 12.)

It would seem obvious that the mere fact of the receivership of the railroad company took away the power to pay the interest on obligations of the corporation which had lost control of its property. The Receivers were not acting for the corporation, but were acting for the Court in a suit brought by the creditors of the corporation.

Any apparent net income in the hands of the Court could not be used for the payment of interest until the Court had determined what its debts might

be in the administration of the property through its Receivers. In this case the difference between the deductions, other than interest, and the gross income derived from the operation of the railroad during the year amounted to $1,408,034.99, but this sum in receivership could not be used as the basis by the Court of a *net income* within the meaning of the Act of Congress inasmuch as it was subject at all times to the debts which the Court might incur and which in fact had been incurred, although not paid, and which of necessity could not be determined until the receivership was closed and all expenses had been liquidated. *United States* vs. *Jones,* 236 U. S. 106; 59 L. Ed. 488.

Again, the income derived during the operation of receivership cannot be considered as income in the sense that it might be if the same amount had resulted from the operation by a corporation, inasmuch as such income formed part of the corpus of the property in the hands of the Court upon which the lien of the creditors existed and which would pass, after expenses of receivership and administration had been deducted, to the purchaser of the property under foreclosure.

The Receivers, therefore, in making the return stated that the $1,408,034.99 which would have been applicable for interest at the hands of the corporation and which they stated would have been used for the purpose of payment of interest by the Western Pacific Railway Company, was held in

abeyance and was subject to disposition by order of the Court which had appointed the Receivers. How long the Court would hold the fund in abeyance and when the Court would order its disposition or for what purposes, could not be told until the termination of the receivership and the final judgment in the cause in which the Receivers were appointed.

Where the Court has restrained a person from doing an act, such person cannot be penalized for failure to do that which he is not permitted to do.

It is true that the Act of 1913 allowed a corporation to make a deduction on account of interest, only where such interest had not only accrued but also had been paid during the year for which the return was made. But while the interest on the obligation of the corporation in this case continued to accrue notwithstanding the receivership, the receivership proceeding put it out of the power of the corporation (which had lost control of its property) to pay the interest which had so accrued. On the other hand, the Receivers, from the very nature of their appointment, had no power to pay such interest on behalf of the corporation. We have then, in this case, the anomalous situation of the Commissioner of Internal Revenue directing the Collector to report for assessment the Western Pacific Railway Company, the corporation, on an income which was derived, not through the operation by the corporation, but through Receivers of

the Court in whose custody, control and management the property of the corporation rested. At the same time the Commissioner of Internal Revenue denied the right of the corporation to deduct an interest charge which had accrued against it on its funded debt but which it had no power to pay.

It is respectfully submitted, therefore,—

1st—That the Court had the jurisdiction to entertain the petition of its Receivers and, therefore, had the jurisdiction to make the order of August 21st, 1916;

2nd—That the Act of Congress of October 3rd, 1913, did not require receivers of corporations to pay income taxes derived from the operation of the property of the corporation by the Court through its receivers;

3rd—That, even if it should be held that the Act of Congress above referred to does apply to receivers of corporations, still the interest on the obligations of the corporation can be deducted from the gross income notwithstanding that it had not been actually paid.

It is submitted that the Order of the lower Court should be affirmed.

Respectfully submitted,

A. R. Baldwin,
Attorney for Appellees.